

# Average and Marginal Returns to Upper Secondary Schooling in Indonesia

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## Abstract

This paper estimates average and marginal returns to schooling in Indonesia using a non-parametric selection model estimated by local instrumental variables, and data from the Indonesia Family Life Survey. The analysis finds that the return to upper secondary schooling varies widely across individual: it can be as high as 50 percent

per year of schooling for those very likely to enroll in upper secondary schooling, or as low as –10 percent for those very unlikely to do so. Returns to the marginal student (14 percent) are well below those for the average student attending upper secondary schooling (27 percent).

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## 1. Introduction

The expansion of access to secondary schooling is at the center of development policy in most of the developing world. Analyzing the effects of such expansion requires knowledge of the impact of education on earnings. In contrast with the standard model, much of the recent literature on the returns to schooling emphasizes that returns vary across individuals, and are correlated with the amount of schooling an individual takes (e.g., Card, 2001, Carneiro, Heckman and Vytlacil, 2011). In terms of the traditional Mincer equation,  $Y = a + bS + u$  (where  $Y$  is log wage and  $S$  is years of schooling),  $b$  is a random coefficient potentially correlated with  $S$ . This has dramatic consequences for the way we conduct policy analysis.

In this model there is no single average return that summarizes the distribution of returns to schooling in the population. For example, the individual at the margin between two levels of schooling may have very different returns from all the infra-marginal individuals. Standard instrumental variables estimates of the returns to schooling estimate the Local Average Treatment Effect (or LATE; Imbens and Angrist, 1994), which does not in general correspond to the return to the marginal person, who is most likely to be affected by the expansion of secondary schooling than anyone else in the economy. Furthermore, different policies may affect different groups of individuals.

This paper studies the returns to upper secondary schooling in Indonesia in a setting where  $b$  varies across individuals and it is correlated with  $S$  (which in this paper is a dummy variable indicating whether an individual enrolls in upper secondary school or not). We find that the return to upper secondary schooling for the *marginal* person who is indifferent between going to secondary schooling or not is much lower than that of the *average* person enrolled in upper secondary schooling (14.2% vs. 26.9% per year of schooling).<sup>1</sup> Finally, we simulate what would happen if distance to upper secondary schooling was reduced by 10% for everyone in the sample, and we estimate that the return to upper secondary schooling for those induced to attend schooling by such an incentive is 14.2%.

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<sup>1</sup> The estimated average and marginal returns to upper secondary schooling in Indonesia are 96% and 111% respectively. Average years of schooling for those who have and who have not enrolled in upper secondary schooling in Indonesia are 13.133 and 5.341, so the difference between the two is 7.79. We use this number to annualize the returns to schooling from total return.

When evaluating marginal expansions in access to school, the relevant quantities are the returns and costs for the marginal student, not the returns and costs for the average student. In spite of the importance of this topic, there are hardly any estimates of average and marginal returns to schooling in developing countries. Two exceptions using Chinese data are Heckman and Li (2004) and Wang, Fleisher, Li and Li (2011).

Estimating the extent to which returns vary across individuals is also important if we want to understand schooling choices, and their relationship with labor market performance. Studying who is more likely to attend school, and documenting how returns differ between those who attain high and low levels of education, and across individuals more generally, is essential for learning about the main incentives and constraints to school attendance.

We estimate a semi-parametric selection model of upper secondary school attendance and wages using the method of local instrumental variables (Heckman and Vytlacil, 2005). Our data comes from the Indonesia Family Life Survey. Carneiro, Heckman and Vytlacil (2011) use a similar model to estimate the returns to college in the US. Although they examine a different country in a different time period, and a different level of schooling, they also find that the returns to college vary widely across individuals in the US, and that the return to college for the marginal student is well below the return to college for the average student (see also Carneiro and Lee, 2009, 2011).<sup>2</sup>

These papers document, across very different environments, how important it is to account for heterogeneity in the returns to schooling. They also show how it is possible to take exactly the same data which is used to estimate a measure of the return to education by instrumental variables methods (IV), and extract much more information from it (allowing us to characterize the heterogeneity in returns across individuals). This can be done using fairly standard parametric methods for estimating selection models, or using a more recent non-parametric approach to the same problem.

Vytlacil (2002) shows that the assumptions underlying standard IV estimates of the effect of a particular program (such as attendance of upper secondary school) are the same as the assumptions underlying a fairly standard non-parametric selection model, and

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<sup>2</sup> There exist also papers which estimate returns for average and marginal student but which account only for selection and heterogeneity given by observable variables (ignoring selection on unobservables). One example is Dearden, McGranahan and Sianesi (2004).

thus the two are equivalent. Heckman and Vytlačil (2001a, 2005) explain how to estimate the model using the method of Local Instrumental Variables. We present estimates from both parametric and non-parametric models. Both show the importance of heterogeneity. The former are more precise than the latter, but the parametric model is more restrictive.

This paper also proposes a methodological innovation. In the presence of multiple control variables, constructing various average parameters of interest (average returns for different groups of individuals) using the framework of Heckman and Vytlačil (2005) requires the estimation of high dimensional conditional densities, which are notoriously difficult to implement. We use instead a simulation method that avoids this high dimensional non-parametric estimation problem (in contrast, Carneiro, Heckman and Vytlačil, 2010, 2011, need to impose restrictive assumptions to reduce the dimensionality of the problem).

Since schooling is endogenously chosen by individuals, we require (at least) one instrumental variable for schooling. We propose to use as the instrument the distance from the community of residence to the nearest secondary school (Card, 1995). Distance takes the value zero if there is a school in the community of residence. This variable is a strong determinant of enrolment in upper secondary school. But one could be concerned that the forces driving the location of schools and parents are correlated with wages, implying that distance is an invalid instrument. We discuss this problem in detail.

We control for several family and village characteristics, namely father's and mother's education, an indicator of whether the community of residence was a village, religion, whether the location of residence is rural, province dummies, and distance from the village of residence to the nearest health post. Our assumption is that if we take two individuals with equally educated parents, with the same religion, living in a village which is located in an area that is equally rural, in the same province, and at the same distance of a health post, then distance to the nearest secondary school is uncorrelated with direct determinants of wages other than schooling. We present evidence that this assumption is likely to hold. In particular, we show that, once these variables are controlled for, there is no correlation between the distance to the nearest secondary school and whether the individual ever failed a grade in elementary school, how many times he repeated a grade in elementary school, and whether he had to work while

attending elementary school. In addition, we show (using a different sample) that our distance variable is uncorrelated with test scores (Math, Bahasa, Science, and Social Studies) in elementary school. These are very important dimensions of the pre-secondary school experience that are measures of early ability and early home environments, and which we would expect to be correlated with distance to the nearest secondary school if this variable was endogenously determined.

Our instrumental variable estimates of the returns to schooling are higher than the returns to schooling for Indonesia found in Duflo (2000) with the qualification that the dataset, the instrumental variable, and the time period are not the same. Petterson (2010) finds similar rates of return using the same year, same data but a different sample and a different instrument variable.

This paper proceeds as follows. Section 2 discusses the data. Section 3 reviews the econometric framework. Section 4 presents our empirical results. Section 5 concludes.

## **2. Data**

We use data from the third wave of the Indonesia Family Life Survey (IFLS) fielded from June through November, 2000<sup>3</sup>. The IFLS is a household and community level panel survey that has been carried out in 1993, 1997 and 2000. The 2000 sample was drawn from 321 randomly selected villages, spread among 13 Indonesian provinces containing 83% of the country's population containing over 43,000 individuals. The sample we used consists of males aged 25-60 who are employed in the labor market and who have reported non-missing wage and schooling information. We consider only salaried workers, both in the government and in the private sector. We exclude females from the analysis because of low labor force participation, and we exclude self-employed workers because it is difficult to measure their earnings. The dependent variable in our analysis is the log of the hourly wage. Hourly wages are constructed from self-reported monthly wages and hours worked per week. The final sample contains 2608 working age males.

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<sup>3</sup> For a description of the survey see Strauss, J., K. Beegle, B. Sikoki, A. Dwiyanto, Y. Herawati and F. Witoelar. "The Third Wave of the Indonesia Family Life Survey (IFLS): Overview and Field Report", March 2004. WR-144/1-NIA/NICHD. In the appendix we list the main variables we use.

In our empirical model we collapse schooling into two categories: i) completed lower secondary or below, and ii) attendance of upper secondary or higher. While this division groups together several levels of schooling, it greatly simplifies the model and is standard in many studies of the returns to schooling (e.g., Willis and Rosen, 1979). The transition to upper secondary schooling is of substantial interest in the Indonesian context given its current effort to expand secondary education. We present both the return to upper secondary schooling, as well as an annualized version of this parameter which we obtain by dividing the estimated return by the difference in average years of schooling completed by those with lower secondary or less and those with upper secondary or more. Upper secondary schooling corresponds to 10 or more years of completed education.<sup>4</sup> In order to compare our estimates with the rest of the literature (in particular, Duflo, 2000) in the appendix we also present OLS and IV estimates of returns using a continuous education variable, corresponding to years of completed schooling.

We run ordinary least squares (OLS) and IV regressions of log wages on years of schooling. The control variables we use are dummies for age, indicators of the level of schooling completed by each of the parents (no education, elementary education, secondary education; we also have an indicator for unreported parental education), an indicator for whether the individual was living in a village at age 12, dummies for the province of residence, an indicator of rural residence, and distance (in Km) from the community of residence to the nearest community health post.

Our instrumental variable for schooling is the distance from the office of the community head to the nearest secondary school. The distance is self-reported by the community head in the Service Availability Roster of the IFLS.<sup>5</sup>

Table 2 presents descriptive statistics on the main variables used in our analysis. It shows that individuals with upper secondary or higher levels of education have, on average, 108% higher wages than those with lower education. They also have 7.778 more years of schooling. The respondents with an upper secondary education are younger than

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<sup>4</sup> It is possible to estimate a non-parametric selection model with multiple levels of schooling but the data requirements to do it are very strong. In particular, one needs one instrumental variable for each transition. It is not feasible to pursue this with our dataset.

<sup>5</sup> We would have liked to use instead the distance between the community of residence in childhood and the nearest school in childhood. Our hope is that current residence and current school availability are good approximations (as in Card, 1995). We show below that this measure of distance to school is a good predictor of upper secondary school attendance.



those without. They are also more likely to have better-educated parents, to have lived in towns or cities at age 12, and to live closer to upper secondary schools, when compared to those with less than an upper secondary education.

### 3. Theoretical Framework

#### 3.1 A Semi-Parametric Selection Model

We consider a standard discrete choice model of schooling, as used in Willis and Rosen (1979) or Carneiro, Heckman and Vytlačil (2011). Consider a model with two schooling levels:

$$\begin{aligned} Y_1 &= \alpha_1 + X\beta_1 + U_1 \\ Y_0 &= \alpha_0 + X\beta_0 + U_0 \end{aligned} \quad (1)$$

$$S = 1 \text{ if } Z\gamma - U_s > 0 \quad (2)$$

$Y_1$  are log wages of individuals with upper secondary education and above,  $Y_0$  are log wages of individuals without upper secondary education,  $X$  is a vector of observable characteristics that might affect wages, and  $U_1$  and  $U_0$  are the error terms.  $Z$  is a vector of characteristics affecting the schooling decision.

Equation (2) is a reduced form model of schooling. Agents decide whether to enroll or not in upper secondary schooling based on the expected net present value of earnings with and without upper secondary schooling, and costs, which can be financial or psychic. There can also be liquidity constraints. There is heterogeneity and we expect agents with the highest returns to upper secondary schooling ( $Y_1 - Y_0$ ) to be more likely to enroll in higher levels of schooling. Costs and returns to schooling can be arbitrarily correlated. For a more detailed explanation see Willis and Rosen (1979) or Carneiro, Heckman and Vytlačil (2011).

It is convenient to rewrite the selection equation as:

$$S = 1 \text{ if } P(Z) > V \quad (3)$$

$P(Z) = F_{U_s}(Z\gamma)$  and  $V = F_{U_s}(U_s)$  and  $F_{U_s}$  is a cumulative distribution function of  $U_s$ .  $V$  is distributed uniformly by construction. This is an innocuous transformation given that  $U_s$  can have any density.

Finally, observed wages are:

$$Y = SY_1 + (1 - S)Y_0 \quad (4)$$

Notice that the return to schooling is

$$Y_1 - Y_0 = \alpha_1 - \alpha_0 + X(\beta_1 - \beta_0) + U_1 - U_0 \quad (5)$$

The return to schooling varies across individuals with different  $X$ 's and different  $U_1, U_0$ .

We require that  $Z$  is independent of  $(U_1, U_0)$  given  $X$ , and that  $Z$  is correlated with  $S$  (see Heckman and Vytlačil, 2005, for the full set of assumptions). These are the usual IV assumptions. In practice we use a stronger assumption:  $X, Z$  is independent of  $U_1, U_0, U_S$ . This stronger assumption is fairly standard in empirical applications of a selection model of the type described here. We discuss the advantages of using this stronger assumption in the empirical section (see also Carneiro, Heckman and Vytlačil, 2011).

The marginal treatment effect (MTE) is the central parameter of our analysis. In the notation of our paper it can be expressed as:

$$\begin{aligned} MTE(x, v) &= E(Y_1 - Y_0 \mid X = x, V = v) \\ &= \alpha_1 - \alpha_0 + x(\beta_1 - \beta_0) + E(U_1 - U_0 \mid X = x, V = v) \end{aligned} \quad (6)$$

The MTE measures the returns to schooling for individuals with different levels of observables ( $X$ ) and unobservables ( $V$ ), and therefore it provides a simple characterization of heterogeneity in returns. Heckman and Vytlačil (2005) show how to construct parameters of interest as weighted averages of the MTE. For example:

$$\begin{aligned} ATE(x) &= \int MTE(x, v) f_{V|x}(v \mid x) dv \\ ATT(x) &= \int MTE(x, v) f_{V|x}(v \mid x, S = 1) dv \\ ATU(x) &= \int MTE(x, v) f_{V|x}(v \mid x, S = 0) dv \end{aligned} \quad (7)$$

where  $ATE(x)$  is the average treatment effect,  $ATT(x)$  is average treatment on the treated,  $ATU(x)$  is average treatment on the untreated (conditional on  $X=x$ ), and  $f_{V|x}(v \mid x)$  is the density of  $V$  conditional on  $X$ .

A less standard parameter but equally (if not more) important is the policy relevant treatment effect (PRTE), introduced in the literature by Heckman and Vytlačil (2001b). It measures the average return to schooling for those induced to change their enrolment status in response to a specific policy. Obviously, it depends very much on the policy being considered. Consider a determinant of enrolment  $Z$ , which does not enter directly

in the wage equation. The policy shifts  $Z$  from  $Z=z$  to  $Z=z'$ . The weights for the corresponding PRTE are:

$$PRTE(x) = \int MTE(x, v) f_{V|x}(v|x, S(z) = 0, S(z') = 1) dv$$

### 3.2 Estimating the MTE

Assuming that the unobservables in the wage (1) and selection (2) equations are jointly normally distributed the MTE can be estimated a standard switching regression model (see Heckman, Tobias and Vytlacil, 2001). Assume:

$$U_0, U_1, U_s \sim N(0, \Omega) \quad (8)$$

where  $\Omega$  represents the variance and covariance matrix. Under this assumption:

$$MTE(x, v) = E(Y_1 - Y_0 | X = x, V = v) = (\alpha_1 - \alpha_0) + x(\beta_1 - \beta_0) + \left( \frac{\sigma_{U_s,1}}{\sigma_{U_s}} - \frac{\sigma_{U_s,0}}{\sigma_{U_s}} \right) \Phi^{-1}(P(Z))$$

where  $\sigma_{U_s}^2$  denotes variance of  $U_s$ ,  $\sigma_i^2$  variance of  $U_i$  with  $i = 0, 1$ ,  $\sigma_{U_s, i}^2$  covariance between  $U_s$  and  $U_i$ ,  $\sigma_{i, j}^2$  the covariance between  $U_i$  and  $U_j$  and  $\Phi$  is the c.d.f. of the standard normal. Therefore MTE can be constructed by estimating parameters  $\alpha_1, \alpha_0, \beta_1, \beta_0, \rho_1, \rho_2$ .

This model relies on strong assumptions about the distribution of the error terms in equations (1-2). To relax these restrictions, we use the method of local instrumental variables that imposes no distributional assumptions on the unobservables of the model (Heckman and Vytlacil, 2000). In particular, Heckman and Vytlacil (2000) show that:

$$MTE(x, v) = \frac{\partial E(Y | X, P)}{\partial P} \Big|_{X=x, P=v} \quad (9)$$

where,

$$\begin{aligned} E(Y | X, P) &= E[\alpha_0 + X\beta_0 + S(\alpha_1 - \alpha_0) + SX(\beta_1 - \beta_0) + U_0 + S(U_1 - U_0) | X, P] \\ &= \alpha_0 + X\beta_0 + P(\alpha_1 - \alpha_0) + PX(\beta_1 - \beta_0) + E(U_1 - U_0 | S = 1, X, P)P \\ &= \alpha_0 + X\beta_0 + P(\alpha_1 - \alpha_0) + PX(\beta_1 - \beta_0) + K(P) \end{aligned} \quad (10)$$

( $K(P)$  is a function of  $P$ , which can be estimated non-parametrically). Therefore, taking the derivative of (10) with respect to  $P$ :

$$MTE(x, v) = \frac{\partial E(Y | X, P)}{\partial P} \Big|_{X=x, P=v} = X(\beta_1 - \beta_0) + K'(P) \quad (11)$$

$V$  can take values from 0 to 1. However, in practice it is only possible to estimate the MTE over the observed support of  $P$ . In our data the support of  $P$  is almost the full unit interval, so we are able to estimate the MTE close to its full support.

If we had assumed that  $Z$  is independent of  $(U_1, U_0)$  given  $X$ , instead of full independence between  $(Z, X)$  and  $(U_1, U_0)$ , it would be much more difficult to estimate the MTE with full support. In that case, for each value of  $X$  it is only possible to estimate the MTE over the support of  $P$  conditional on  $X$ , which in general can be much smaller than the unconditional support of  $P$  (for a detailed discussion see Carneiro, Heckman and Vytlačil, 2011). The assumption of full independence of  $(Z, X)$  and  $(U_1, U_0)$  is fairly standard and it allows us to use the full support of  $P$ .

Equations (10) and (11) can be estimated using standard methods. In particular, we use the partially linear regression estimator of Robinson (1988) to estimate  $(\beta_1, \beta_0)$ . Then we compute  $R = Y - [\alpha_0 + X\beta_0 + PX(\beta_1 - \beta_0)]$ .  $(\alpha_1, \alpha_0)$  cannot be identified separately from  $K(P)$ .  $K(P)$  and  $K'(P)$  is estimated using a locally quadratic regression (Fan and Gijbels, 1996) of  $R$  on  $P$ . A simple test of heterogeneity in the impact by unobserved characteristics is a test of whether  $K'(P)$  is flat, or if  $E(Y | X, P)$  is nonlinear in  $P$ . If the derivative is flat then heterogeneity is not important.

### 3.3 Average Marginal Returns to Education

Economic decisions involve comparisons of marginal benefits and marginal costs. Therefore it is especially interesting to estimate the returns to upper secondary schooling for those individuals at the margin between enrolling or not. These would be those individuals more likely to change their schooling as a response to a change in education policy.

The definition of who is marginal depends on the policy being considered. This is made clear in Carneiro, Heckman and Vytlačil (2010, 2011), who consider three particularly interesting definitions of individuals at the margin:

$$i)|P - V| < \varepsilon, \text{ ii)}|Z\gamma - U_s| < \varepsilon, \text{ iii)}\left|\frac{P}{U} - 1\right| < \varepsilon.$$

These correspond to three different marginal policy changes.<sup>6</sup>

In this paper we estimate the average marginal returns to upper secondary schooling in Indonesia according to the definition of marginal in ii) above, although we could have chosen a different one. The MTE provides a general characterization of heterogeneity in returns and from it we can construct various other parameters.

Carneiro, Heckman and Vytlacil (2010) show how it is possible to write the average marginal treatment effect (or AMTE, the return for the marginal person) as a weighted average of the MTE:

$$AMTE(x) = \int MTE(x, v) f_{X,V}(v | |Z\gamma - U_s| < \varepsilon, x) dv \quad (12)$$

### 3.4 Estimating vs. Simulating the Weights: A New Procedure

So far this section has shown how to recover the MTE from the data, and how to construct economically interesting parameters as weighted averages of the MTE. Heckman and Vytlacil (2005) and Carneiro, Heckman and Vytlacil (2010) provide formulas for the necessary weights in equations 7 and 12, conditional on  $X$ . Once these are applied it is simple to average over the relevant distribution of  $X$ , when that is what is required. In particular, these papers show that:

$$\begin{aligned} f_{V|X}(v) &= 1 \\ f_{V|X}(v | X, S = 1) &= \frac{1 - F_{P|X}(v | X)}{E(P | X)} \\ f_{V|X}(v | X, S = 0) &= \frac{F_{P|X}(v | X)}{E(P | X)} \\ f_{V|X}(v | X, S(z) = 0, S(z') = 1) &= \frac{F_{P|X}(v | X) - F_{P|X}(v | X)}{\int [F_{P|X}(v | X) - F_{P|X}(v | X)] dv} \\ f_{V|X}(v | X, |Z\gamma - V| < \varepsilon) &= \frac{f_{P|X}(v | X) f_{U_s|X}[F_{U_s|X}^{-1}(v | X)]}{E[f_{U_s|X}(Z\gamma | X)]} \end{aligned} \quad (13)$$

<sup>6</sup> The three policy changes considered are (i) a policy that increases the probability of attending college by an amount  $\alpha$ , so that  $P_\alpha = P_0 + \alpha$ ; (ii) a policy that changes each person's probability of attending college by the proportion  $(1 + \alpha)$ , so that  $P_\alpha = (1 + \alpha)P_0$ ; and (iii) a policy intervention that has an effect similar to a shift in one of the components of  $Z$ , say  $Z^k$ , so that  $Z_\alpha^k = Z^k + \alpha$  and  $Z_\alpha^j = Z^j$  for  $j \neq k$ .

where  $f_{P|X}(p|X)$  and  $F_{P|X}(p|X)$  are respectively the p.d.f and the c.d.f. of  $P$  conditional on  $X$ ,  $f_{U_S|X}(u_S|X)$  and  $F_{U_S|X}(u_S|X)$  are respectively the p.d.f and the c.d.f. of  $U_S$  conditional on  $X$ , and  $F_{P|X}(p|X)$  is the c.d.f. of  $P$  conditional on  $X$  when  $Z$  takes value  $z'$ .

In practice it is difficult to implement these formulas since they involve estimation of conditional density and distribution functions, and  $X$  is a high dimensional object in many applications (there are 28 variables in  $X$  in our empirical work). Therefore, Carneiro, Heckman and Vytlacil (2010, 2011) have aggregated  $X$  into an index, namely  $I = X(\beta_1 - \beta_0)$ , and proceeded by estimating conditional densities and distributions of  $P$  with respect to  $I$ .

There is little theoretical basis for this aggregation which makes it quite unattractive. In this paper we use an alternative procedure, which avoids making this aggregation, and sidesteps the problem of estimating a multidimensional conditional density function.

Notice that the selection equation relates  $S$ ,  $X$ ,  $Z$ , and  $U_S$  or  $V$ . Using the estimates of the parameters of the selection equation, it is straightforward to simulate the following objects:

$$f_{V|X}(v|x), f_{V|X}(v|S = 1, x), f_{V|X}(v|S = 0, x), f_{V|X}(v||Z\gamma - U_S| < \varepsilon, x)$$

Once we have these, we just need apply them to equations (7) and (12). This simulation procedure is simple, and its steps are described in detail in the appendix.

## 4. Empirical Results

### 4.1 Is Distance to School a Valid Instrument?

To account for the potential endogeneity of the schooling decision we instrumented schooling with the distance to the nearest secondary school, measured in kilometers.<sup>7</sup> In order for this to be a valid procedure distance to school needs to satisfy two assumptions: i) distance to school should affect the probability of school enrolment and ii) it should have no direct effect on adult wages.

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<sup>7</sup> Distance to the nearest school has been used as an instrument for schooling by Card (1995), Kane and Rouse (1995), Kling (2001), Currie and Moretti (2003), Cameron and Taber (2004) and Carneiro, Heckman and Vytlacil (2011).

Condition ii) is controversial if families and schools do not randomly locate across locations in Indonesia. For example, Carneiro and Heckman (2002) and Cameron and Taber (2004) show that individuals living closer to universities in the US have higher levels of cognitive ability and come from better family backgrounds. In fact, it is also true in Indonesia that those who have better educated parents are located closer to secondary schools. However, it is possible that school location is exogenous after we account for a very detailed set of individual and regional characteristics, namely: age (or cohort), parental education, religion, an indicator for whether the individual was living in a city or in village at age 12, an indicator for whether the individual lived in a rural area at age 12, dummies for the province of residence, and distance to the nearest health post.

One way to investigate the plausibility of this assumption is to check whether distance to the nearest secondary school is correlated with pre-secondary educational outcomes of each individual. If there was non-random sorting of families and schools across locations in such a way that distance to secondary school was correlated with adult wages, it would surely appear in these variables.

Table 3 examines whether distance to upper secondary school is correlated with whether an individual ever repeated a grade in elementary school, the number of repetitions in elementary school (both of which are measure of early school success), and whether the individual worked while in primary school. If our instrument is valid it should not be correlated with such early measures. Our results show no apparent correlation between distance to school and these variables.

In addition, Table 4 examines comprehensive exam scores in math, science, social studies and Bahasa. The sample used in this table is not exactly the sample used in our regressions, because it is only possible to gather elementary school test scores for a very small proportion of individuals in our original sample. Therefore, in the regression showed in this table, we placed no age or gender restrictions in the sample. Again, we find no correlation between the distance to school and test scores.<sup>8</sup> This evidence is suggestive that our empirical strategy is valid.

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<sup>8</sup> Considering a more restricted sample results in a small number of observations. Our main conclusions are unchanged, but results are fairly imprecise.

The first column of Table 5 shows that distance to the nearest secondary school is a strong predictor of enrolment in secondary school. We run a logit regression where the dependent variable is an indicator taking value 1 if an individual ever attended upper secondary school and the regressors include distance to the nearest secondary school and all the control variables mentioned above. The table displays marginal effects of each variable on the probability of enrolling in upper secondary education. We include distance to health post as a proxy for location characteristics and, unlike distance to school, distance to health post does not predict school enrollment. Children of highly educated parents are more likely to attend upper secondary school than children of parents with low levels of education. Catholics and Protestants are much more likely to attend secondary school than Muslims (the omitted category). Children living in small villages and in rural areas were less likely to attend upper secondary school than those living in large cities and urban areas.

In the second column of table 5 we present estimates of a more flexible model where the impact of distance on secondary school attendance varies with  $X$ . In particular, we interact distance to school with age (which, for a fixed year, also captures cohort), religion, parental education, and rural residence. It is useful to estimate this richer model for two related reasons. First, it is much more flexible than the model in column 1. Second, because by allowing the impact of the instrument to vary with the variables in  $X$  we allow the effect of the instrument to vary more. As a result, the standard errors in the IV estimates and in the selection model are smaller than if we just use the model in column 1. Therefore, the basic estimates in this paper will come from this model, while estimates of the simpler model are presented in the appendix (we discuss them below).

Notice also that table 5 displays p-values for tests of the null hypothesis that distance to school does not affect upper secondary school attendance. In column 1, we look to the single coefficient on distance, while in column 2 we perform a joint test on all coefficients involving distance. In both columns we reject that distance to school does not determine upper secondary school attendance.

There is another important reason why condition ii) may be violated. If regions where schools are abundant are also regions where other infrastructure is also abundant, then we may be confounding the impact of school availability on wages with the impact of other



infrastructure on wages (see the argument in Jalan and Ravallion, 2002). This will be true unless labor is perfectly mobile, which is unlikely to be the case in Indonesia.

However, we include detailed regional controls in our models which should absorb much of this variation. Therefore, our argument is that our assumption is valid conditional on all the controls we have in the model. In addition, we show that removing these detailed regional controls hardly affects our results, which indicates that this problem is unlikely to be that important in our setting. Perhaps, as Duflo (2004) argues, the response of other infrastructure (be it private or public) to school construction and to a better skilled workforce is very slow.

## 4.2 Standard Estimates of the Returns to Schooling

In order to more easily make a comparison between our data and estimates and those in the literature we start by presenting standard OLS and IV estimates of the returns to schooling. Throughout the paper schooling takes two values: 0 for less than upper secondary, and 1 for upper secondary or above. We use the log hourly wage in 2000 as our dependent variable. The full set of controls consists of: age (or cohort), parental education, religion, an indicator for whether the individual was living in a city or in a village at age 12, an indicator for whether the individual lived in a rural area at age 12, dummies for the province of residence, and distance to the nearest health post.

We present ordinary least squares (OLS) and IV results. This is shown in Table 6. The annualized OLS estimate of the return to upper secondary schooling is 9%, while the IV estimate is 12.9%. Recall from table 2 that individuals with upper secondary schooling or above have on average 13.133 years of schooling, while those with less than upper secondary have on average 5.341 years of schooling. The difference between the two groups is 7.792 years of schooling. Using this figure to annualize the returns to upper secondary education we have an OLS estimate of 9% ( $=70.5\%/7.792$ ) and an IV estimate of 12.9% ( $=100\%/7.792$ ).<sup>9</sup>

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<sup>9</sup> Appendix table A1 presents OLS and IV estimates where we use years of schooling as the main explanatory variable (as opposed to upper secondary schooling). The first column in this table shows coefficients of an OLS regression of log wages on years of schooling and several controls. The estimated return to a year of schooling is 9.6%. The second column shows the first stage of the two stage least squares estimator, i.e., a regression of years of schooling on the instrument and the control variables. It shows that distance to school is negatively related to schooling attainment. Finally, column 3 shows the IV estimate of the return to schooling, which is 15.7%.

These estimates are higher than (but of comparable magnitude to) those in Duflo (2001), although we use more recent data. Petterson (2010) finds a return of 14% using the same data from the same year but a different sub-sample and instrument.

As in most of the literature, our IV estimates of the return to education are larger than OLS estimates. Card (2001) suggests that such a finding indicates that returns to schooling are heterogeneous and the marginal individual induced to enroll in school by the change in the instrument has a higher return than the average individual. Carneiro, Heckman and Vytlačil (2011) show that in the case of college attendance in the US, IV estimates can be above OLS estimates even if the marginal individual has a lower return than the average. Another reason why IV can exceed OLS is measurement error in schooling. Although schooling is relatively well measured in the US (Card, 1999) and other developed countries, that is not necessarily the case in Indonesia.

In appendix table A2 we also present IV estimates of returns for models where we do not interact the instrument with the variables in  $X$ . The point estimate is smaller than the one in Table A1, and the standard error is larger. Nevertheless, the main pattern remains: the IV estimate is much higher than the OLS estimate. In a model with heterogeneous returns, it is not surprising that the instrumental variable is sensitive to the choice of instrument. For the remaining of the paper, we present a parallel set of results in the appendix in which we do not interact the instrument with  $X$  in the selection equation.<sup>10</sup> Finally, in appendix table A3 we present results where we omit all regional dummies from the model. Our IV estimate is very similar to the ones in tables A1 and A2. This indicates that regional variation in infrastructure, which is correlated with the availability of schooling, is unlikely to be driving our results.

OLS and IV estimates hide considerable heterogeneity in returns and, as emphasized in Heckman and Vytlačil (2005), Heckman, Urzua and Vytlačil (2006), and Carneiro, Heckman and Vytlačil (2011), it is not clear what economic question is answered by the IV estimate. In order to further investigate this issue we use the framework of section 3.

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<sup>10</sup> We do this for two reasons. First, to show that the main patterns in our results are not driven by choosing the specific way the instrument enters the model. Second, because the first stage F-statistic is higher in the case where we use a single IV ( $F=11.34$ ) than when we use multiple IVs ( $F=3.62$ ) consisting of distance interacted with different components of  $X$ . We will see throughout the paper that using the expanded set of instruments allows us to get similar results and lower standard errors than we use a single (but apparently stronger) instrument.

We estimate parametric (assuming joint normality of  $(U_1, U_0, U_S)$ ) and semi-parametric versions of the model (which does not put assumptions on the joint distribution of  $(U_1, U_0, U_S)$ ).

### 4.3 Average and Marginal Treatment Effect Estimates

We start with the semi-parametric model. We construct  $P$  as a predicted probability of ever attending upper secondary school from a logit regression of upper secondary school attendance on the  $X$  and  $Z$  variables of section 3. Table 5, discussed above, reports the coefficients of the logit model. All average derivatives presented in the table have the expected sign.

It is only possible to identify the MTE over the support of  $P$ . Therefore, we need to examine the density of  $P$  for individuals who attend upper secondary school or above and those who do not. This is done in both panels of Figure 1, which shows the distributions of the predicted propensity score ( $P$ ) for these two groups. The supports for these distributions overlap almost everywhere, although the support at the tails is thin for low values of  $P$  among those with upper secondary school or above. We construct the MTE as described in Section 2. In order to estimate  $K(P)$  we run a local quadratic regression of  $R$  on  $P$ , using a Gaussian kernel and a bandwidth of 0.2. The implied  $MTE(x, v)$  is computed by calculating the slope on the linear term of the local quadratic regression.<sup>11</sup>

Figure 2 displays the estimated MTE (which we evaluate at the mean values of the components of  $X$ ). The MTE is monotonically decreasing for all values of  $V$ . Returns are very high for individuals with low values of  $V$  (individuals who are more likely to enroll in upper secondary school or facing high costs). The figure demonstrates substantial heterogeneity in the return to schooling, which ranges from 34% for individuals with  $V$  around 0.1 to 13% for those with  $V$  close to 0.5, and becomes negative for those with values of  $V$  close to 1. The fact that returns are the lowest for individuals who are least likely to go to school is consistent with a simple economic model where agents sort themselves based on their comparative advantage.

Unfortunately the standard errors on our estimated MTE are quite wide (standard errors are estimated using the bootstrap). However, it is still possible to reject that the

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<sup>11</sup> The coefficients on  $X$  in the outcome equations are presented in table A4 in the appendix.

MTE is flat. Table 7 tests whether adjacent segments of the MTE are equal. Take, for example, the first line of the table. In the first column we show the average value the MTE takes when  $X$  is fixed at its mean and  $V$  takes values between 0.1 and 0.2, while the second column corresponds to values of  $V$  between 0 and 0.1. The third column shows the t-statistic for a test of whether the numbers in the first two columns are equal. We reject equality in almost all lines of the table at the 5% significance level. Therefore, we are able to reject that the MTE is flat, even with the large standard error bands shown in figure 2.

Standard errors improve when we estimate the MTE assuming joint normality of  $(U_1, U_0, U_S)$  as shown in Figure 3. The shape of the MTE is declining as in Figure 2, although the normality assumption does not allow the MTE to have a flat section as in Figure 2 so the MTE is declining everywhere, again taking negative values for very high values of  $V$ .

Table 8 presents average returns to upper secondary schooling for different groups of individuals. The return to upper secondary school for a random person is 12.3%. The return for the individuals who were enrolled in upper secondary schooling is considerably higher, at 26.9%. If individuals who did not go to upper secondary school would have gone there, they could expect the returns of 1.7%. In the parametric case the average parameters are estimated with the assumption of full support. Estimates of the return to the marginal student (AMTE) are robust to the lack of full support. The return to the marginal student is 14.2%, well below the return to the average student in upper secondary school (26.9%).

Finally, the last line of Table 8 reports the average return for those induced to attend upper secondary school by a particular policy shift: a 10% reduction in distance to an upper secondary school. This is the parameter needed to understand the impacts of such an education expansion. By coincidence, it is remarkably similar to the MPRTE.

In the appendix we show that results are similar but more imprecise when we do not interact  $Z$  and  $X$  in the selection equation. This is reassuring, and shows the usefulness for the precision of our estimates of accounting for a more flexible model.<sup>12</sup>

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<sup>12</sup> See tables A2 , A5 and A6, and figures A1, A2 and A3.

## 5. Conclusion

Indonesia has an impressive record of educational expansion since the 1970s. The enrollment rates are nearly universal for elementary schooling and are around 75% for secondary education. There is an ongoing effort to extend universal education attainment to the secondary level. And although enrollment in secondary education continues to rise we find striking inequality in returns to education. The individuals who are most likely to be attracted by educational expansions at the upper secondary level (marginal) have lower average returns than those already attending upper secondary schooling. In this paper we document a large degree of heterogeneity in the returns to upper secondary schooling in Indonesia. We estimate the return to upper secondary education to be 12 percentage points higher (per year of schooling) for the average than for the marginal student.

Therefore, efforts aimed at educational expansion will attract students with much lower levels of returns, although the returns are still fairly high for the marginal person, and therefore further expansions are probably justified. But our estimates also show that it is probably not optimal to bring everybody into upper secondary education.

Is it possible to reduce such a high degree of inequality in the returns to schooling? There is a growing body of literature that argues that human capital outcomes later in life are largely determined early in life (e.g., Carneiro and Heckman, 2003). It is therefore important for the design of schooling policy to determine whether the inequality in secondary schooling outcomes can be remedied at earlier stages, for example during elementary education or even earlier. In an impressive drive to increase the quantity of education, there should be a renewed emphasis on quality of education that ensures a more relevant learning environment for the disadvantaged children that reduces the inequity in lifetime outcomes. This can be achieved by raising the return for the marginal student, and therefore the increased equity need not cost in terms of efficiency.

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**Table 1: Definitions of variables used in the empirical analysis**

Variable	Definition
Y	Log hourly earnings for salaried males
S = 1	Ever enrolled in upper secondary school; zero otherwise
X	Age, age squared, respondent's religion – protestant, catholic and other, mother's and father's education – elementary, secondary or higher, distance to the nearest health post in km from the community, rural residence, province of residence – West Sumatra, South Sumatra, Lampung, Jakarta, Central Java, Yogyakarta, East Java, Bali, West Nussa Tenggara, South Kalimantan, South Sulawesi
Z	Distance in km to nearest secondary school from community heads office, interactions of distance with age, age squared, religion, parental education and rural residence

**Table 2: Sample statistics for the treatment groups**

	<i>Upper secondary or higher</i>	<i>Less than upper secondary</i>
	<i>N = 1085</i>	<i>N = 1523</i>
Log hourly wages	8.198	7.481
Years of education	13.133	5.341
Distance to school in km	1.053	1.564
Distance to health post in km	0.889	1.079
Age	37.058	38.675
Religion Protestant	0.050	0.022
Catholic	0.029	0.009
Other	0.062	0.043
Muslim	0.860	0.927
Father uneducated	0.130	0.383
...elementary	0.503	0.507
...secondary and higher	0.330	0.061
...missing	0.020	0.037
Mother uneducated	0.201	0.425
...elementary	0.484	0.406
...secondary and higher	0.204	0.022
...missing	0.098	0.133
Rural household	0.240	0.476
North Sumatra	0.057	0.063
West Sumatra	0.047	0.058
South Sumatra	0.048	0.032
Lampung	0.016	0.027
Jakarta	0.181	0.095
Central Java	0.085	0.163
Yogyakarta	0.092	0.054
East Java	0.121	0.180
Bali	0.056	0.038
West Nussa Tenggara	0.050	0.048
South Kalimantan	0.040	0.020
South Sulawesi	0.035	0.035

Source: Data from IFLS3. Sample restricted to males aged 25-60 employed in salaried jobs in government and private sectors. Hourly wages constructed based on self-reported monthly wages.

**Table 3: Regression of elementary education experience on distance to school**

	<b>Failed grade</b>	<b>Number of repeats</b>	<b>Worked</b>
Dist to nearest secondary school in km	0.007 (0.007)	0.011 (0.008)	-0.001 (0.005)
Individual and family controls		Yes	
Location fixed effect		Yes	
Number of observations	2,248	2,244	2,250
R2	0.041	0.043	0.043

Note: Sample restricted to males with the repeated grade information non-missing. The individual and family controls include age, age squared, religion, fathers and mother's schooling levels completed, distance to local health outpost, rural and province dummies. Standard errors are robust to clustering at the community level. Standard Errors are in the parentheses with significance at \*\*\* p<0.001, \*\* p< 0.05, \* p<0.1 indicated.

**Table 4: Regression of comprehensive exam test scores from elementary school on distance to school**

	<b>Math</b>	<b>Bahasa</b>	<b>Science</b>	<b>Social Studies</b>
Distance to nearest secondary school	0.001 (0.005)	-0.002 (0.005)	-0.004 (0.005)	-0.005 (0.005)
Individual and family controls			Yes	
Location fixed effect			Yes	
Number of observations	1,652	1,668	1,621	1,605
R2	0.134	0.187	0.124	0.115

Note: Sample includes everyone with non-missing test scores. Test scores recorded from score cards. The individual and family controls include age, age squared, religion, fathers and mother's schooling levels completed, distance to local health outpost, rural and province dummies. Standard errors are robust to clustering at the community level. Absolute t-statistics are in the parentheses with significance at \*\*\* p<0.001, \*\* p< 0.05, \* p<0.1 indicated.

**Table 5: Upper school decision model – Average Marginal Derivatives**

	Coef/(se)	Average Derivative/(se)
Dist to sec school in km	-0.123*** (0.040)	-0.0300** (0.0127)
Age	0.077* (0.044)	0.0130 (0.0090)
Age Squared	-0.096* (0.055)	-0.0162 (0.0111)
Protestant	0.730*** (0.264)	0.1382*** (0.0484)
Catholic	1.211*** (0.395)	0.2123** (0.0890)
Other religions	0.245 (0.363)	0.0552 (0.0878)
Fathers education elementary	0.766*** (0.127)	0.1342*** (0.0217)
Father higher education	1.835*** (0.178)	0.3769*** (0.0320)
Mother education elementary	0.443*** (0.123)	0.0852*** (0.0230)
Mother higher education	1.851*** (0.237)	0.3730*** (0.0418)
Rural	-0.593*** (0.110)	-0.1143*** (0.0276)
Distance to health post in km	-0.017 (0.040)	0.0000 (0.0083)
Location fixed effect		Yes
Test for joint significance of instruments: Chi-square/p-value	9.42/0.0021	22.26/0.051

Note: This table reports the coefficients and average marginal derivatives from a logit regression of upper school attendance (a dummy variable that is equal to 1 if an individual has ever attended upper school and equal to 0 if has never attended upper secondary school but graduated from lower secondary school. Type of location is controlled for using province dummy variables. Dummy variable for missing parental education is included in the regressions but not reported in the table. The first column presents coefficients of logit where only distance to school is used an IV. In the second column average derivatives are presented and instruments include distance to secondary school and interactions with all the Xs. Reference categories are Muslim, not educated. Standard errors are robust to clustering at the community level. Standard Errors are in the parentheses with significance at \*\*\* p<0.001, \*\* p< 0.05, \* p<0.1 indicated.

**Table 6: Annualized OLS and IV estimates of the return to upper secondary schooling**

	OLS	2SLS IV estimate
Upper secondary (annualized)	0.090*** (0.005)	0.129*** (0.048)
Age	0.052*** (0.019)	0.048** (0.020)
Age Squared	-0.042* (0.023)	-0.037 (0.025)
Protestant	0.182** (0.084)	0.142 (0.104)
Catholic	0.059 (0.189)	0.001 (0.202)
Other religions	0.109 (0.126)	0.097 (0.125)
Fathers education elementary	0.135*** (0.048)	0.091 (0.070)
Fathers education secondary or higher	0.215*** (0.067)	0.101 (0.153)
Mother's education elementary	-0.052 (0.048)	-0.080 (0.060)
Mother's education secondary or higher	-0.031 (0.078)	-0.128 (0.136)
Rural household	0.111** (0.045)	0.152** (0.068)
Distance to health post in km	-0.023 (0.018)	-0.020 (0.017)
Location controls	YES	YES
Number of observations	2,608	2,608
Test for joint significance of instruments: F-stat/p-value	2.22/0.00	
R2	0.210	0.190

Note: This table reports the coefficients for OLS and 2SLS IV for regression of log of hourly wages on upper school attendance (a dummy variable that is equal to 1 if an individual has ever attended upper school and equal to 0 if has never attended upper secondary school but graduated from lower secondary school. controlling for parental education, religion and location. First stage results report average marginal derivative. Excluded instruments are distance to secondary school and interactions with parental education, religion and age. Type of location is controlled using province dummies. Dummy variable for missing parental education is included in the regressions but not reported in the table. Reference categories are Muslim, not educated. Standard errors are robust to clustering at the community level. Standard Errors are in the parentheses with significance at \*\*\* p<0.001, \*\* p< 0.05, \* p<0.1 indicated.

**Table 7: Testing for heterogeneity in returns: comparing adjacent sections of the semi-parametric MTE**

Ranges of $U_S$ for $LATE^j$	(0,0.1)	(0.1,0.2)	(0.2,0.3)	(0.3,0.4)	(0.4,0.5)	(0.5,0.6)	(0.6,0.7)	(0.7,0.8)	(0.8,0.9)
Ranges of $U_S$ for $LATE^{j+1}$	(0.1,0.2)	(0.2,0.3)	(0.3,0.4)	(0.4,0.5)	(0.5,0.6)	(0.6,0.7)	(0.7,0.8)	(0.8,0.9)	(0.9,1)
Difference in LATEs	-0.078	-0.039	-0.013	-0.012	0.00	0.005	-0.014	-0.024	-0.04
$p$ -value	0.00	0.00	0.00	0.00	0.597	0.759	0.005	0.00	0.00

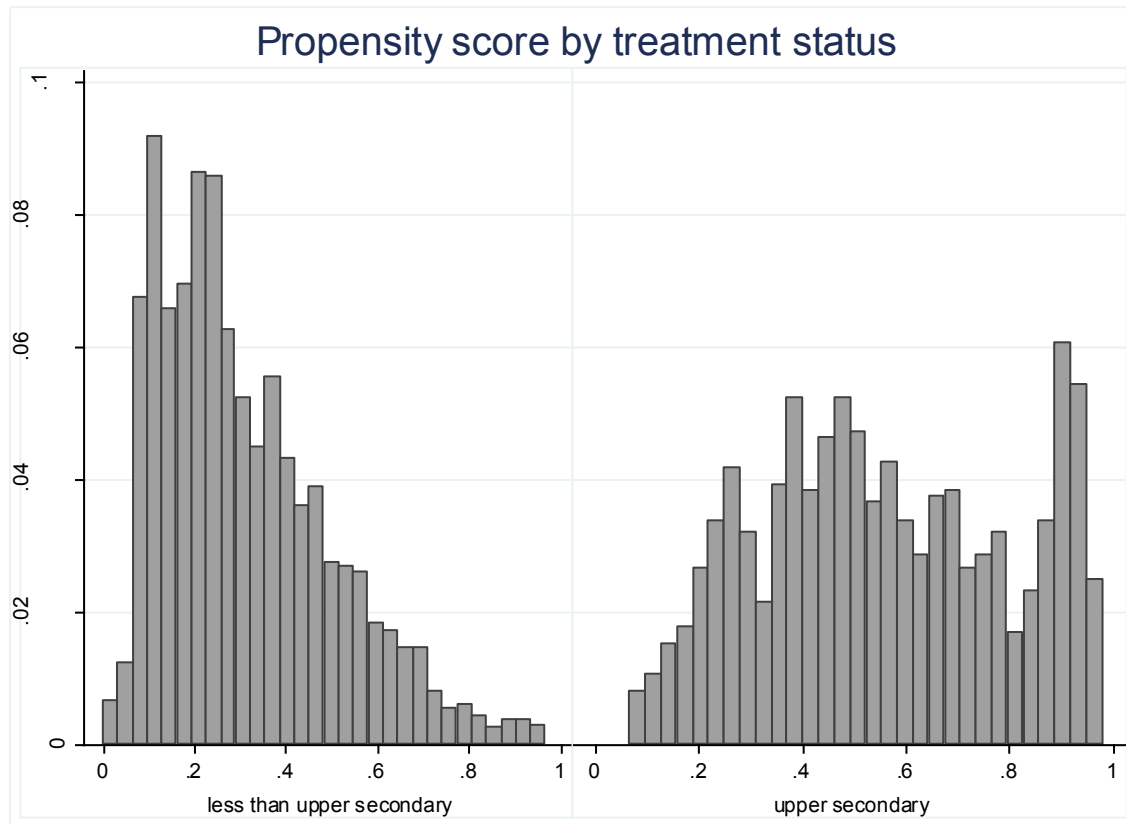
Note: In order to compute the numbers in this table we construct groups of values of  $U_S$  and average the MTE within these groups, where  $U_S^{L_j}$  and  $U_S^{H_j}$  are the lowest and highest values of  $U_S$  defined for interval  $j$ . Then we compare the average MTE across adjacent groups and test whether the difference is equal to zero using the bootstrap with 250 replications.

**Table 8: Estimates of Average Returns to Upper Secondary Schooling with 95% confidence interval**

<i>Parameter</i>	<i>Non parametric Estimate</i>	<i>Normal selection model</i>
ATT	0.269*** (.069, 0.47)	0.201*** (0.05,0.35)
ATE	0.123* (-0.019, 0.266)	0.066 (-0.029,0.163)
ATU	0.017 (-0.236, 0.27)	-0.029 (-0.175,0.116)
MPRTE	0.142*** (.038, 0.246)	
PRTE	0.142*** (.038, 0.247)	

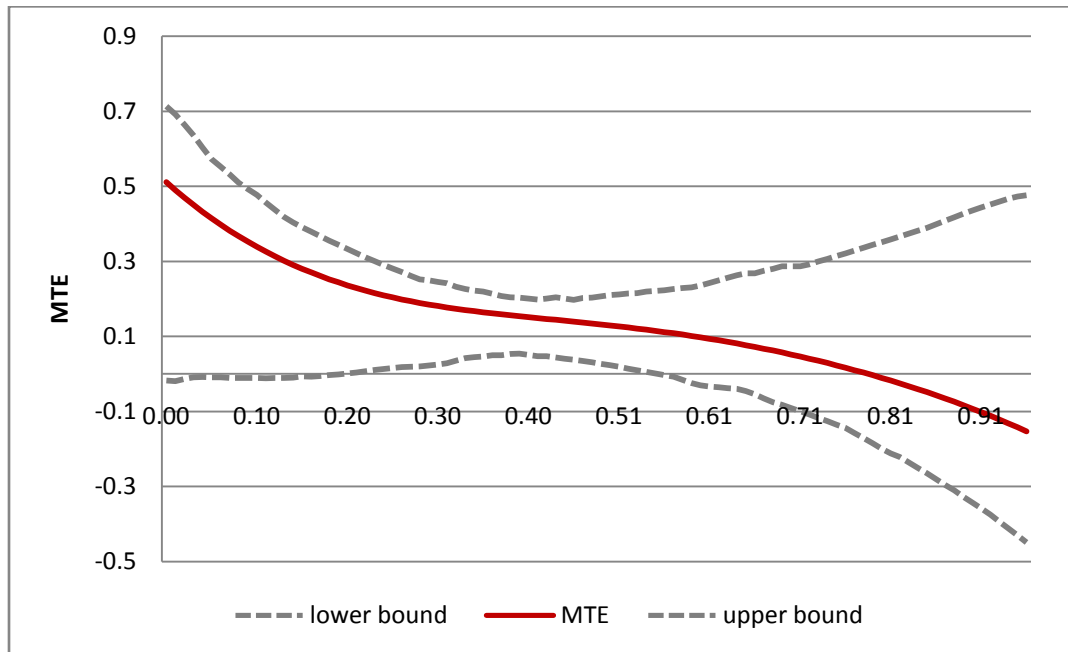
Note: This table presents estimates of various returns to upper secondary school attendance for the semi-parametric and normal selection models: average treatment on the treated (ATT), average treatment effect (ATE), treatment on the untreated (ATU), and marginal policy relevant treatment effect (MPRTE). Returns to upper school are annualized to show returns for each additional year. Standard errors bootstrapped using 250 repetitions. 95% confidence interval in parentheses. Absolute t-statistics are in the parentheses with significance at \*\*\*  $p < 0.001$ , \*\*  $p < 0.05$ , \*  $p < 0.1$  indicated.

**Figure 1: Propensity score ( $P$ ) support for each schooling group  $S = 0$  and  $S = 1$**



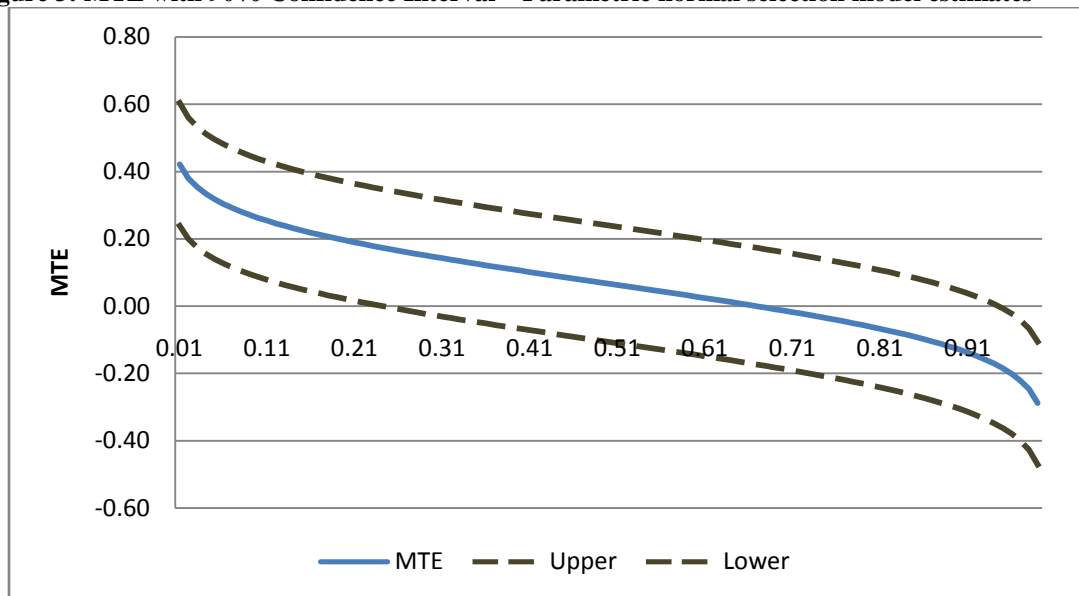
Note:  $P$  is estimated probability of going to upper secondary school. It is estimated from a logit regression of upper school attendance on  $X$ s, distance to school, interactions of  $X$  and distance to school (See Table 5).

**Figure 2: Marginal treatment effect with 90% Confidence Interval – Semi-parametric regression estimates**



Note: To estimate the  $E(Y_1 - Y_0 | X, U_s)$  function we used a partial linear regression of log wages on X and K(P), with a bandwidth of 0.2. X includes age, age squared, religion, parental education, rural and province dummy variables. 90% confidence interval constructed using 250 bootstrap repetitions. Values of V on the x-axis.

**Figure 3: MTE with 90% Confidence Interval – Parametric normal selection model estimates**



Note: Parametric MTE is estimated using the standard switching regression model.



## Appendix

### Simulation-based approach for estimating average treatment effects in equations 7 and 12.

Step 1: Estimate  $MTE(x, v)$  as described in section 3.

Step 2: For each individual in the sample construct the corresponding  $P(Z)$  and take  $n$  draws from  $V \sim Unif[0,1]$  (recall that we assumed that  $V$  was independent of  $X$  and  $Z$ ). Since there are 2608 individuals in the sample this creates a simulated dataset of size  $2608 \cdot n$  (we use  $n=1000$ ). Evaluate the  $MTE(x, v)$  for each value of  $X$  and each value of simulated  $V$ .

Step 3: In this simulated dataset both  $X$  and  $V$  are observed for all  $2608 \cdot n$  observations. In addition, we have estimates of  $MTE(x, v)$  for each of them. Therefore it is trivial to construct the following quantities:

$$ATE = \iint MTE(x, v) f_{X,V}(x, v) dx dv$$

$$ATT = \iint MTE(x, v) f_{X,V}(x, v | S = 1) dx dv = \iint MTE(x, v) f_{X,V}(x, v | P > V) dx dv$$

$$ATU = \iint MTE(x, v) f_{X,V}(x, v | S = 0) dx dv = \iint MTE(x, v) f_{X,V}(x, v | P \leq V) dx dv$$

by respectively averaging the  $MTE$  for everyone in the simulated sample, for those who have  $P > V$ , and for those with  $P \leq V$ .

Step 4: There is one parameter that remains to be estimated: the AMTE. The version of the AMTE we use in this paper defines marginal individuals as those for whom:

$$|Z\gamma - U_s| < \varepsilon$$

Carneiro, Heckman and Vytlacil (2010) show that this is equivalent to estimating the average return to schooling for those induced to enroll in upper secondary schooling when one of the components of  $Z$ , say the intercept, changes by a marginal amount. This is exactly what we do in our simulations: we change the intercept of the selection equation marginally and we see which members of our simulated dataset change their schooling decision. Finally, we average the  $MTE$  for this group.

**Table A1: OLS and IV estimates of the return to a year of schooling**

	OLS		First stage		IV estimate	
	Coef	se	Average Marginal Derivative	se	Coef	se
Years of education	0.096***	0.005			0.157***	0.037
Age	0.058***	0.017	0.027	0.078	0.055***	0.018
Age Squared	-0.047**	0.022	-0.062	0.098	-0.042*	0.022
Muslim						
Protestant	0.084	0.082	2.033	0.381	-0.037	0.118
Catholic	0.003	0.152	2.196	0.856	-0.117	0.149
Other religions	0.055	0.121	0.987	0.754	0.002	0.128
Father uneducated						
... elementary	0.062	0.048	1.759	0.228	-0.049	0.080
... secondary or higher	0.135**	0.067	3.627	0.312	-0.083	0.144
Mother uneducated						
... elementa	-0.086*	0.046	1.000	0.216	-0.147**	0.063
... secondary or higher	-0.119	0.078	3.173	0.344	-0.316**	0.145
Rural household	0.149***	0.044	-1.146	0.301	0.234***	0.073
Distance to health post in km	-0.020	0.015	0.037	0.084	-0.015	0.013
Location controls			Yes			
Dist to nearest sec school			-0.298***	0.102		
Number of observations	2,608				2,608	
Test for joint significance of instruments: F-Stat/p-value			3.62/0.000			
R2	0.260				0.204	

Note: This table reports the coefficients for OLS and 2SLS IV for regression of log of hourly wages on years of schooling controlling for parental education, religion and location. First stage results report average marginal derivative. Excluded instruments are distance to secondary school and interactions with parental education, religion, age and distance to health center. Type of location is controlled using province dummies. Dummy variable for missing parental education is included in the regressions but not reported in the table. Standard errors are robust to clustering at the community level. Standard Errors are in parentheses with significance at \*\*\* p<0.001, \*\* p< 0.05, \* p<0.1 indicated.

**Table A2: IV estimates of the return to a year of schooling without distance and X interactions**

	IV estimate		First stage	
	coef	se	coef	se
Years of education	0.144***	0.053		
Age	0.056***	0.017	0.036	0.077
Age Squared	-0.043*	0.022	-0.072	0.096
Muslim				
Protestant	-0.011	0.141	2.050***	0.380
Catholic	-0.091	0.164	2.229**	0.906
Other religions	0.014	0.128	0.839	0.778
Father uneducated				
... elementary	-0.025	0.102	1.800***	0.231
... secondary or higher	-0.036	0.198	3.525***	0.316
... education missing	-0.034	0.109	0.353	0.444
Mother uneducated				
... elementary	-0.134*	0.073	0.973***	0.215
... secondary or higher	-0.274	0.185	3.180***	0.331
... education missing	-0.183***	0.063	0.367	0.301
Rural household	0.215**	0.091	-1.144***	0.302
Distance to health post in km	-0.016	0.013	0.007	0.082
W Java				
N Sumatra	0.114	0.088	-0.615	0.500
W Sumatra	0.282**	0.112	-0.704	0.476
S Sumatra	0.137	0.125	0.667	0.476
Lampung	-0.044	0.108	0.149	0.477
Jakarta	-0.077	0.078	0.752*	0.421
C Java	0.051	0.091	-0.937*	0.498
Yogyakarta	-0.303***	0.100	1.128**	0.570
E Java	-0.007	0.066	-0.300	0.411
Bali	-0.197	0.159	1.027	0.946
W Nusa Tenggara	-0.176	0.107	0.715	0.839
S Kalimantan	0.298**	0.114	1.726***	0.540
S Sulawesi	0.032	0.097	0.226	0.702
Dist to nearest sec school			-0.244***	0.072
Number of observations	2,608			
Test for joint significance of instruments:			11.34/0.00	
F-stat/p-value				
R2	0.206			

Note: This table reports the coefficients for 2SLS IV for regression of log of hourly wages years of schooling, controlling for parental education, religion and location. Excluded instruments are distance to secondary school. Type of location is controlled using province dummies. Dummy variable for missing parental education is included in the regressions but not reported in the table. Reference categories are Muslim, not educated. Standard errors are robust to clustering at the community level. Standard Errors are in the parentheses with significance at \*\*\* p<0.001, \*\* p<0.05, \* p<0.1 indicated.

**Table A3: IV estimates of the return to a year of schooling without regional dummies**

	IV estimate	
	coef	se
Years of education	0.135 <sup>***</sup>	0.034
Age	0.059 <sup>***</sup>	0.018
Age Squared	-0.046 <sup>**</sup>	0.022
Muslim		
Protestant	-0.032	0.100
Catholic	-0.153	0.154
Other religions	-0.109	0.091
Father uneducated		
... elementary	-0.006	0.077
... secondary or higher	-0.004	0.141
... education missing	-0.002	0.107
Mother uneducated		
... elementary	-0.074	0.057
... secondary or higher	-0.190	0.131
... education missing	-0.156 <sup>***</sup>	0.060
Rural household	0.227 <sup>***</sup>	0.072
Distance to health post in km	-0.008	0.014
Number of observations	2,608	
Test for joint significance of instruments: F-stat/p-value	4.08/0.00	
R2	0.22	

Note: This table reports the coefficients for 2SLS IV for regression of log of hourly wages years of schooling, controlling for parental education, religion and location. Excluded instruments are distance to secondary school. Type of location is controlled using province dummies. Dummy variable for missing parental education is included in the regressions but not reported in the table. Reference categories are Muslim, not educated. Standard errors are robust to clustering at the community level. Standard Errors are in the parentheses with significance at <sup>\*\*\*</sup> p<0.001, <sup>\*\*</sup> p< 0.05, <sup>\*</sup> p<0.1 indicated.

**Table A4: Outcome equation: Partial linear regression estimates**

	<b>Coefficients</b>	<b>Standard Errors</b>
Age	0.070*	0.042
Age Squared	-0.076	0.051
Protestant	-0.022	0.368
Catholic	-0.816	0.634
Other religions	0.786*	0.406
Father with elementary education	0.042	0.192
... secondary or higher	0.103	0.675
... education missing	0.425	0.292
Mother with elementary education	-0.144	0.156
... secondary or higher	-1.570*	0.938
... education missing	-0.173	0.170
Rural household	0.288*	0.161
Distance to health post in km	-0.016	0.030
N Sumatra	0.333	0.214
W Sumatra	0.177	0.218
S Sumatra	0.233	0.309
Lampung	0.253	0.294
Jakarta	-0.248	0.233
C Java	0.071	0.153
Yogyakarta	-0.127	0.301
E Java	-0.071	0.149
Bali	-1.022**	0.478
W Nusa Tenggara	-0.267	0.325
S Kalimantan	0.013	0.451
S Sulawesi	-0.434	0.274
N Sumatra	-0.550	0.465
S Sumatra	-0.134	0.595
C Java	-0.197	0.415
Yogyakarta	-0.127	0.602
E Java	0.326	0.357
Bali	1.660*	0.898
W Nusa Tenggara	0.192	0.711
S Kalimantan	0.367	0.860
W Sumatra*P	0.465	0.535
Lampung*P	-0.993	0.839
Jakarta*P	0.394	0.452
S Sulawesi*P	0.979	0.598
Age*P	-0.069	0.097
Age Squared*P	0.124	0.121
Protestant*P	0.130	0.639
Catholic*P	1.171	0.931
Other religions*P	-1.261*	0.703
Father with elementary*P	0.053	0.605
Father with secondary/higher*P	0.002	1.280
Father education missing*P	-1.322	0.942
Mother with elementary*P	0.187	0.393
Mother with secondary/higher*P	1.977	1.433
Mother education missing*P	0.109	0.458
Rural*P	-0.275	0.362
Distance to health post*P	0.037	0.082
Number of observations	2,608	
R2	0.080	

note: \*\*\* p<0.01, \*\* p<0.05, \* p<0.1 The table presents the coefficients on X and P\*X from the Robinson's

**Table A5: Testing for equality of LATEs over different Intervals of MTE**

	$(H_0: LATE^j(U_S^{L_j}, U_S^{H_j}) - LATE^{j+1}(U_S^{L_{j+1}}, U_S^{H_{j+1}}) = 0)$								
Ranges of $U_S$ for $LATE^j$	(0,0.1)	(0.1, 0.2)	(0.2,0.3)	(0.3,0.4)	(0.4,0.5)	(0.5,0.6)	(0.6,0.7)	(0.7,0.8)	(0.8,0.9)
Ranges of $U_S$ for $LATE^{j+1}$	(0.1, 0.2)	(0.2,0.3)	(0.3,0.4)	(0.4,0.5)	(0.5,0.6)	(0.6,0.7)	(0.7,0.8)	(0.8,0.9)	(0.9,1)
Difference in LATEs	-0.078	-0.04	-0.014	-0.012	-0.010	-0.011	-0.012	-0.014	-0.014
p-value	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00

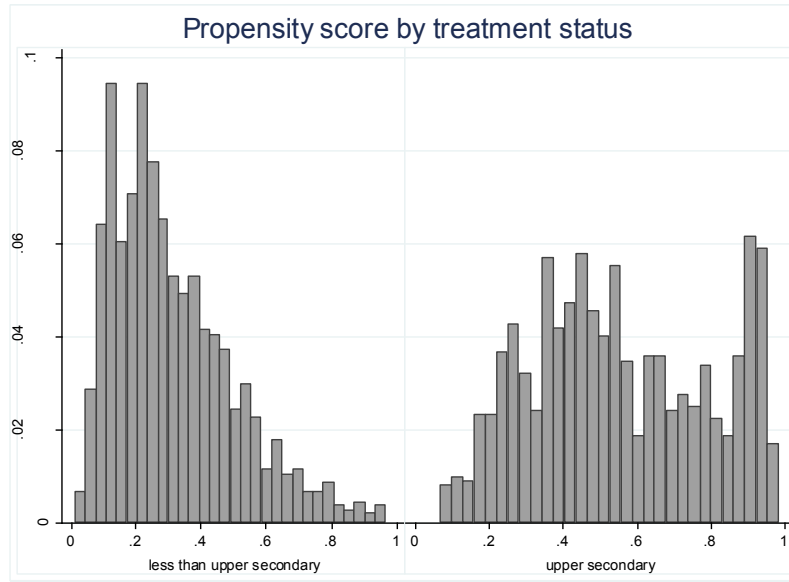
Note: In order to compute the numbers in this table we construct groups of values of  $U_S$  and average the MTE within these groups, where  $U_S^{L_j}$  and  $U_S^{H_j}$  are the lowest and highest values of  $U_S$  defined for interval  $j$ . Then we compare the average MTE across adjacent groups and test whether the difference is equal to zero using the bootstrap with 250 replications.

**Table A6: Estimates of Average Returns to Upper Secondary Schooling with 95% confidence interval**

<i>Parameter</i>	<i>Non parametric Estimate</i>	<i>Normal selection model</i>
ATT	0.217 (-1, 0.525)	0.198** (-0.041, 0.438)
ATE	0.13 (-0.06, 0.32)	0.065 (-0.099, 0.231)
ATU	0.07 (-0.227, 0.365)	-0.028 (-0.217, 0.160)

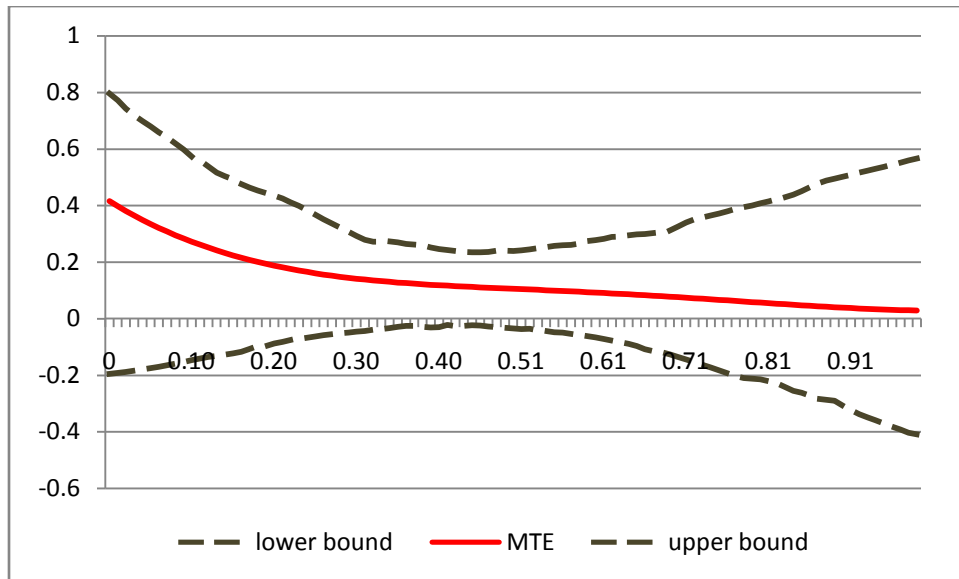
Note: This table presents estimates of various returns to upper secondary school attendance for the semi-parametric and normal selection models: average treatment on the treated (ATT), average treatment effect (ATE), treatment on the untreated (ATU), and marginal policy relevant treatment effect (MPRTE). Returns to upper school are annualized to show returns for each additional year. Standard errors bootstrapped using 250 repetitions. 95% confidence interval in parentheses. Absolute t-statistics are in the parentheses with significance at \*\*\*  $p < 0.001$ , \*\*  $p < 0.05$ , \*  $p < 0.1$  indicated.

**Figure A1: Propensity score ( $P$ ) support for each schooling group  $S = 0$  and  $S = 1$**



Note:  $P$  is estimated probability of going to upper secondary school. It is estimated from a logit regression of upper school attendance on  $X$ s, distance to school, interactions of  $X$  and distance to school (See Table 5).

**Figure A2: Marginal treatment effect with 90% Confidence Interval – Semi-parametric regression estimates (without distance and  $X$ s interactions)**



Note: To estimate the  $E(Y_1 - Y_0 | X, U_s)$  function we used a partial linear regression of log wages on  $X$  and  $K(P)$ , with a bandwidth of 0.2.  $X$  includes age, age squared, religion, parental education, rural and province dummy variables. 90% confidence interval constructed using 250 bootstrap repetitions. Values of  $V$  on the x-axis.

**Figure A3: MTE with 90% Confidence Interval – Parametric normal selection model estimates**

